In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-844

P. L. SNYDER,

Petitioner,

v.

RIDC INDUSTRIAL DEVELOPMENT FUND,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

Petitioner has attempted to frame as a single question for review what are in fact two separate but related questions, neither of which presents a substantial federal issue meriting the consideration of this Court:

I. Whether the Fifth Circuit erred in construing the phrase "any indebtedness . . . remaining unpaid . . . shall be cancelled, discharged and distinguished" found in a plan of arrangement confirmed under Chapter XI of the Bankruptcy Act as having the effect of discharging the bankrupt but not a guarantor of the bankrupt?

II. Whether a guarantor of the debt of a bankrupt is discharged from liability to a secured creditor who participates in the debtor's Chapter XI plan of arrangement, notwithstanding that Section 16 of the Bankruptcy Act (11 U.S.C. §34) expressly provides that the guarantor's liability shall not be altered by the discharge of the bankrupt?

ARGUMENT

I. The Fifth Circuit Correctly Construed The Operative Language In The Plan Of Arrangement And That Construction Does Not Involve A Substantial Federal Question.

Petitioner argues that the phrase in the plan of arrangement providing that "[a]ny indebtedness . . . remaining unpaid after the last of the distributions provided for herein has been made shall be cancelled, discharged, and extinguished" must be interpreted to mean that, not only was the Chapter XI debtor in possession discharged (the statutorily-defined effect of the confirmation of a plan of arrangement), but that the debt itself was annihilated and rendered unenforceable with respect to a guarantor whose obligations are explicitly preserved by Section 16 of the Bankruptcy Act.[1] While petitioner did succeed in persuading the district judge to that view (as an alternative holding),[2] the Fifth Circuit (Circuit Judges Wisdom and Morgan and District Judge Lynne) thought that interpretation so meritless and contrary to normal commercial expectations as to warrant rejection in a footnote.[3]

Petitioner asserts that respondent, as appellant in the Fifth Circuit, did not question the correctness of the district court's interpretation of this particular phrase of the plan of arrangement and that petitioner therefore believed "that holding of the District Court to be beyond the scope of appeal." (Cert. Pet. at 4). That assertion is groundless.

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[1]Section 16 of the Bankruptcy Act, 11 U.S.C §34 (1970), provides:

> "The liability of a person who is a co-debtor with or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of the bankrupt."

[2]387 F. Supp. at 473; Cert. Pet. at 41.

[3]539 F.2d at 490, n. 3; Cert. Pet. at 17.

Respondent's forty-two page principal brief and its eleven page reply brief in the Fifth Circuit made a direct frontal attack on the district court's ruling that petitioner was discharged from his liability as guarantor because of respondent's participation in the plan of arrangement. Inherent and implicit in that attack was respondent's contention that the district court had committed fundamental error in construing the plan of arrangement as discharging petitioner from his liability as guarantor.

Indeed, during oral argument in the Fifth Circuit counsel for petitioner advanced the position, urged here, that the district court's interpretation of the plan of arrangement ("cancelled, discharged and extinguished") constituted a sufficient basis for affirming on appeal, whatever the merit of respondent's other contentions. On rebuttal, counsel for respondent was asked by Circuit Judge Wisdom to speak to this argument. Counsel replied that the interpretation urged was contrary to all reasonable commercial tradition and was merely an inequitable attempt to capitalize on the questionable draftsmanship of a lawyer who, in trying to say the same thing three times, arguably said three different things. The Fifth Circuit obviously agreed with that position.

Petitioner filed a petition for rehearing in the Fifth Circuit in which he again advanced the district court's interpretation of the language in the plan of arrangement as requiring affirmance. The Fifth Circuit denied rehearing summarily. (Cert. Pet. at 49).

Wholly aside from the correctness of the Fifth Circuit's ruling on this point, it is clear that this question—which merely involves the construction of terms found in a plan of arrangement—does not present a substantial federal question and, therefore, does not merit review in this Court.

II. The Fifth Circuit's Decision Is Consistent With Both The Letter And The Spirit Of The Bankruptcy Act.

The Fifth Circuit ruled that the liability of a guarantor is not altered by a secured creditor's participation in the debtor's Chapter XI arrangement proceeding. That ruling is entirely consistent with both the express provisions and the underlying purposes of the Bankruptcy Act.

While it is generally true that a Chapter XI arrangement is a proceeding for the "settlement, satisfaction, or extension . . . of . . . unsecured debts," 11 U.S.C. §706(1), it is equally true that a secured creditor may participate in any bankruptcy proceeding as an unsecured creditor to the extent that his claim exceeds the value of his security. *United States National Bank v. Chase National Bank*, 331 U.S. 28 (1947). In such a case, the discharge in a Chapter XI arrangement of this unsecured indebtedness does not affect the liability of a guarantor of the bankrupt. 11 U.S.C. §34. Indeed, a secured creditor whose claim exceeds the value of his security would prejudice a guarantor, such as petitioner here, by not participating in a Chapter XI arrangement as an unsecured creditor.

Thus, as the Fifth Circuit pointed out in this case,[4] there can be no public policy objections to a secured creditor's participating in a Chapter XI proceeding by surrendering his security to the jurisdiction of the bankruptcy court, permitting the court to value or sell the security, accepting the proceeds in satisfaction of his security interest, and thereafter participating as an unsecured creditor.

Such an option, in fact, makes the Chapter XI procedure a more effective device for all concerned. Where secured creditors (with the indebtedness owed them in default) decline to participate in a Chapter XI arrangement, it is

[4]539 F.2d at 493-94; Cert. Pet. at 23-26.

difficult to secure the necessary consent of unsecured creditors to a plan of arrangement. Should such secured creditors, beyond the statutory power of a Chapter XI bankruptcy court, foreclose or otherwise proceed against the property of the bankrupt which constitutes their security, the ability of the Chapter XI debtor to comply with any plan of arrangement confirmed under that Chapter is doubtful. Unsecured creditors, faced with this uncertainty, will all too often prefer outright liquidation of the debtor where otherwise, had they been able to work with the secured creditors, they might have preferred to let the debtor continue as a going business under Chapter XI. As the Fifth Circuit observed, "it is also to the guarantor's advantage to allow this option since more of the debt will be paid by the debtor."[5]

In summary, the Fifth Circuit's decision on this question:

(1) Is consistent with both the letter and the spirit of the Bankruptcy Act;

(2) Is in conflict with no other decision of any federal court;

(3) Is consistent with an earlier decision of the Fifth Circuit;[6] and

(4) Announces an entirely salutary public policy.

Finally, it should be noted that there are now pending in Congress two bills which would repeal the existing Bankruptcy Act and replace it with a new statute. H.R. 31, 94th Cong., 1st Sess.; H.R. 32, 94th Cong., 1st Sess. Although there is an ongoing legislative debate over the organization and staffing of the bankruptcy courts, both bills would

[5]539 F.2d at 494; Cert. Pet. at 26.

[6]*Armstrong v. Alliance Trust Co.*, 112 F.2d 114 (5th Cir. 1940).

empower a trustee in bankruptcy to assert jurisdiction over secured creditors in arrangement or reorganization proceedings, would empower a trustee or receiver to sell security and distribute the proceeds to the secured creditor, and would thereafter discharge the bankrupt with respect to such secured creditors. Both bills contain a provision, virtually identical to the present Section 16 (11 U.S.C. §34), providing that a discharge of a bankrupt would not affect or alter the liability of guarantors of the bankrupt.

As is well known, prospects for enactment of one or the other of these bills in the near future are good. Hence, this Court, should it grant review, would all too likely be devoting its energies to the interpretation of a statute soon to be repealed.

CONCLUSION

For the foregoing reasons, respondent respectfully submits that the Court should deny the instant petition.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that three copies of the foregoing brief are being served upon counsel for petitioner this 19th day of January, 1977 by air mail, postage prepaid, to the following address:

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